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CHARLES ELMORE

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1935

No. 859

C. L. ASHTON, et al.,

Petitioners,

vs.

CAMERON COUNTY WATER IMPROVEMENT DISTRICT NO. ONE,

Respondent.

MOTION FOR LEAVE TO FILE BRIEF AS AMICI CURIAE IN SUPPORT OF CONTENTIONS OF PETITIONERS

and

BRIEF IN SUPPORT THEREOF.

HERMAN PHLEGER,
MAURICE E. HARRISON,
Crocker Building, San Francisco, California,
As Amici Curiae.

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Table of Contents

	Page
Preliminary Statement	3
Summary of Argument	4
Argument	5
I.	
Neither the state nor its governmental agencies may be subjected to the bankruptcy power	5
(a) The power to borrow on the credit of taxation is vital to the sovereignty of the states	6
(b) The bankruptcy clause contains no warrant for federal interference with the borrowing power of the states	7
(c) If Section 80 were valid, it would seriously limit and hamper the borrowing power of the states	10
(d) Widespread similarity of local conditions or events does not transfer power from the states to the Congress	11
II.	
The lack of power in Congress to subject a state or its governmental agencies to bankruptcy is not aided by the consent of the state	12
III.	
The character of irrigation districts	18
(a) The acts of quasi municipal corporations are acts of the state	19
IV.	
The municipal bankruptcy provision cannot be defended as an "emergency measure"	20
V.	
Section 80 violates the fundamental principles of bankruptcy, and so is not a "law on the subject of bankruptcies"	21
(a) Action under Section 80 is no less a repudiation of public debts because the statute requires the consent of a proportion of creditors	26

VI.

Page

This court has never held that secured creditors, even though members of a class, may be compelled to surrender substantial security rights 27

(a) The holders of public bonds are in effect secured creditors 28

VII.

The fundamental considerations of public policy involved in the repudiation of public debts must be decided by the sovereign whose debts are in question 28

(a) The inviolability of public obligations stands above the bankruptcy power 29

VIII.

Conclusion 29

Table of Authorities Cited

	Pages
A. L. A. Schecter Poultry Corp. v. United States, 295 U. S. 495	21
Ambrosini v. United States, 187 U. S. 1, 47 L. ed. 49	6
Bankruptcy Act:	
Section 78 (11 U. S. C. 301)	20
Section 80 (11 U. S. C. 303)	11
Collector v. Day, 11 Wall. 113, 20 L. ed. 122	5, 6
Columbia L. Rev., Vol. 35, pp. 428, 437, 438	21
Continental Illinois National Bank & Trust Company v. Chicago R. I. & P. R. Co., 294 U. S. 648	27
Eagleson v. Pacific Timber Co., 270 Fed. 1008	22
Fallbrook Irrigation Dist. v. Bradley, 164 U. S. 112, 174	19
Heine v. Board, 19 Wall. 655	26
Hensley v. Reclamation District No. 556, 121 Cal. 96, 97	19
Houck v. Little River Drainage District, 239 U. S. 254, 263	19
Indian Motorcycle Co. v. United States, 283 U. S. 574, 75 L. ed. 1281	6
Jones, Bonds & Bond Securities (4th ed.)	25, 27, 28
Kansas City Terminal Ry. Co. v. Central Union Trust Co., 271 U. S. 445	22
La Mesa Irr. Dist. v. Hornbeck, 216 Cal. 730	24
Lindsay-Strathmore Irrigation District v. Superior Court, 182 Cal. 315, 335	19
Louisville Joint Stock Land Bank v. Radford, 295 U. S. 555	9, 26, 27
Louisville Trust Co. v. Louisville Ry. Co., 174 U. S. 674	22
McQuillin, Municipal Corporations (2d ed.). Vol. 1, Sec. 135	18
Memphis & C. Ry. Co. v. Pace, 282 U. S. 241	19
Mountain States Power Co. v. Jordon Lumber Co., 293 Fed. 502	22
Morrison v. Smith Bros. Inc., 211 Cal. 36	18

Pages

North Dakota, Constitution, Sec. 184 8
Northern Pacific Ry. Co. v. Boyd, 228 U. S. 482 21

Ohio Life Ins. Co. v. Debolt, 16 How. 415 7

Perry v. United States, 294 U. S. 330 ..... 6, 8, 29
Pollard v. Hagan, 3 How. 212 ..... 13, 14

Rahrer, In re, 140 U. S. 545 13
Rees v. Watertown, 19 Wall. 107 26

South San Joaquin Irr. Dist. v. Neumiller, 2 Cal. (2d) 485 24
Stimson, Federal & State Constitutions, p. 290 9
St. Louis, S. F. Ry. Co. v. McElvain, 253 Fed. 123 22

United States v. Butler, ... U. S. .., 80 L. ed. (Adv. Ops.) 287, 56 Sup. Ct. Rep. 312 11

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May it Please the Court:

The undersigned are attorneys for Florence Moore, American Trust Company, as Trustee, and Crocker First National Bank, as Trustee, all as protesting bondholders in The Matter of Merced Irrigation District, which was No. 3907 in Bankruptcy, in the United States District Court for the Southern District of California, Northern Division, and is now

pending on appeal in the United States Circuit Court of Appeals for the Ninth Circuit.

The Merced Irrigation District proceeding is a proceeding under Section 80 of the Bankruptcy Act, as amended, and therefore will probably turn upon questions of law that will be determined in the present case by this Honorable Court.

The undersigned therefore respectfully move this Honorable Court for leave to file their accompanying brief as *amici curiae*.

Dated, San Francisco, California,
April 20, 1936.

HERMAN PHLEGER,
MAURICE E. HARRISON,
As Amici Curiae.

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PRELIMINARY STATEMENT.

The reasons impelling us to file this brief are stated in the accompanying petition for leave to file it, and will not, therefore, be repeated here. We set forth in this brief our contention that Section 80 of the Bankruptcy Act is unconstitutional.

SUMMARY OF ARGUMENT.

Point I. Neither the State nor its governmental agencies may be subjected to the bankruptcy power.

(a) The power to borrow on the credit of taxation is vital to the sovereignty of the States.

(b) The Bankruptcy Clause contains no warrant for federal interference with the borrowing power of the States.

(c) If Section 80 were valid, it would seriously limit and hamper the borrowing power of the States.

(d) Wide-spread similarity of local conditions or events does not transfer power from the States to the Congress.

Point II. The lack of power in Congress to subject a State or its governmental agencies to bankruptcy is not aided by the consent of the State.

Point III. The character of irrigation districts.

(a) The acts of quasi municipal corporations are acts of the State.

Point IV. The municipal bankruptcy provision cannot be defended as an "emergency measure".

Point V. Section 80 violates the fundamental principles of bankruptcy, and so is not a law "on the subject of bankruptcies".

(a) Action under Section 80 is no less a repudiation of public debts because the statute requires the consent of a proportion of creditors.

Point VI. This Court has never held that secured creditors, even when members of a class, may be compelled to surrender substantial security rights.

(a) The holders of public bonds are in effect secured creditors.

Point VII. The fundamental questions of public policy involved in the repudiation of public debts must be decided by the sovereign whose debts are in question.

(a) The inviolability of public obligations stands above the bankrupty power.

Point VIII. Conclusion.

ARGUMENT.

I.

NEITHER THE STATE NOR ITS GOVERNMENTAL AGENCIES MAY BE SUBJECTED TO THE BANKRUPTCY POWER.

We believe that the determining question is whether Congress can or cannot subject the State to bankruptcy proceedings. Once that question is answered, the issue before the Court becomes easy of solution. We submit that it must be answered in the negative, under the doctrine of

Collector v. Day, 11 Wall. 113.

"The States within the limits of their powers not granted, or, in the language of the Tenth Amendment, 'reserved' are as independent of the general government as that government within its sphere is independent of the States. * * * Such being the separate and independent condi-

> tion of the States in our complex system, as recognized by the Constitution, and the existence of which is so indispensable, * * * it would seem to follow, as a reasonable, if not a necessary consequence, that the means and instrumentalities employed for carrying on the operations of their governments, for preserving their existence, and fulfilling the high and responsible duties assigned to them in the Constitution, should be left free and unimpaired, should not be liable to be crippled, much less defeated by the taxing power of another government * * *"

The rule of *Collector v. Day,* has, of course, been followed in later decisions of the Supreme Court:

Ambrosini v. United States, 187 U. S. 1, 47 L. ed. 49;

Indian Motorcycle Co. v. United States, 283 U. S. 574, 75 L. ed. 1281,

and disposes, we submit, of the question put.

We urge that on this authority alone, the Congress has no power to interfere with the management and control by the States of their fiscal affairs.

(a) The power to borrow on the credit of taxation is vital to the sovereignty of the States.

In *Perry v. United States,* 294 U. S. 330, the Court said of the borrowing power of Congress:

> "* * * the right to make binding obligations is a competence attaching to sovereignty. In the United States, sovereignty resides in the people who act through the organs established by the Constitution. * * *
>
> "The Constitution gives to the Congress the power to borrow money on the credit of the

United States, an unqualified power, a power vital to the Government,—upon which in an extremity its very life may depend. The binding quality of the promise of the United States is of the essence of the credit which is so pledged. Having this power to authorize the issue of definite obligations for the payment of money borrowed, the Congress has not been vested with authority to alter or destroy those obligations. The fact that the United States may not be sued without its consent is a matter of procedure which does not affect the legal and binding character of its contracts. While the Congress is under no duty to provide remedies through the courts, the contractual obligation still exists and, despite infirmities of procedure, remains binding upon the conscience of the sovereign."

(b) The Bankruptcy Clause contains no warrant for federal interference with the borrowing power of the States.

The unsurrendered sovereign powers of the States include power to make contracts that may not be repudiated.

The Ohio Life Ins. Co. v. Debolt, 16 How. 416:

Speaking of contracts granting exemption from State taxation, Mr. Chief Justice Taney said:

"There are, undoubtedly, fixed and immutable principles of justice, sound policy and public duty, which no state can disregard without serious injury to the community, and to the individual citizens who compose it. And contracts are sometimes incautiously made by states as well as individuals; and franchises, immunities, and exemptions from public burdens improvidently granted. But whether such contracts should be made or not, is exclusively for the consideration

of the State. It is the exercise of an undoubted power of sovereignty which has not been surrendered by the adoption of the Constitution of the United States, and over which this court has no control. For it can never be maintained in any tribunal in this country, that the people of a state, in the exercise of the powers of sovereignty, can be restrained within narrower limits than those fixed by the Constitution of the United States, upon the ground that they may make contracts ruinous or injurious to themselves * * *

"Banks and other companies may be exempted, by contract, from their equal share of the taxes, under the belief that the corporation will prove to be a public benefit. Experience may prove that it is a public injury. Yet, if the contract was within the scope of the authority conferred by the Constitution of the State, it is like any other contract made by competent authority, binding upon the parties. Nor can the people or their representatives, by any act of theirs afterwards, impair its obligation. When the contract is made, the Constitution of the United States acts upon it, and declares that it shall not be impaired, and makes it the duty of this court to carry it into execution. That duty must be performed."

See also:

Perry v. United States, supra.

Many States have adopted constitutional provisions, of which the following is typical:

Constitution of North Dakota, Sec. 184:

"Any city, county, township, town, school district, or any other political subdivision incurring indebtedness shall at or before the time of so-

> doing, provide for the collection of an annual tax sufficient to pay the interest and also the principal thereof when due, and all laws or ordinances providing for the payment of the interest or principal of any debt shall be irrepealable until such debt be paid."

There are many and varying provisions in other State Constitutions of the same general import. *Stimson, Federal and State Constitutions,* page 290. Nearly all State Constitutions have their own provisions forbidding laws impairing the obligation of contracts. *Stimson,* op. cit., p. 292. It is too clear for argument that the power to adopt provisions like those quoted above is not surrendered to the Federal Government by the United States Constitution, nor forbidden to the States by that instrument.

But if Section 80 of the Bankruptcy Act is valid, then it necessarily supersedes the provisions in State Constitutions like those quoted above. The question inescapably presented, therefore, is the question whether or not the grant to Congress of power to enact uniform laws on the subject of bankruptcy gave Congress power to override provisions like these, adopted by the people of the several States in their Constitutions, whereby public debts for which the taxing power is pledged must be paid. We respectfully submit that there can be but one answer to this question.

Louisville Joint Stock Land Bank v. Radford, 295 U. S. 555, holds that the bankruptcy power is subject to constitutional limitations. It repudiates the view that Congress in exercising the bankruptcy power is

unrestrained by the limitations applicable to other powers. There is nothing magical or transcendant about the power over bankruptcies. Just as in the Frazier-Lemke case, the Fifth Amendment limited the power, so here the reserved rights of the States and the dual scheme of government inherent in the Constitution forbid the exercise of the power. If the bankruptcy power is subject to explicit prohibitions of the Constitution, it is equally subject to those which are implicit.

The grant to Congress of bankruptcy power is very different, we submit, from the grant of power like that contained in the Commerce Clause, under which it is held that Congress may encroach upon and limit the control of the States over local affairs. Most of the powers granted to the Federal Government are powers not only convenient, but necessary to the preservation of national unity. The bankruptcy power, however, is simply one item of police power, granted to the Federal Government because of the ill effects and inconvenience of diverse laws on the subject. There is, therefore, no shadow of need, in aid of the bankruptcy power, to encroach upon the domain of the States. Quite different considerations justify Congressional regulation, for example, of intrastate railroad rates, or Congressional restrictions upon State taxation of national bank stock.

(c) If Section 80 were valid, it would seriously limit and hamper the borrowing power of the States.

Federal power to compel, or to permit, or refuse to permit, repudiation of debts incurred by the States for governmental purposes, and secured by a pledge

of the taxing power, would obviously be power to interfere substantially with the exercise of any and all of the sovereign powers reserved to the States. Clearly, the power to borrow money is essential to the exercise of nearly all the other powers of a State. Section 80 would, by depriving the States of power to make irrevocable contracts, seriously impair and regulate their borrowing power.

Moreover, Section 80 empowers the Federal Bankruptcy Courts to alter contracts made by State agencies in other respects, by

> "modifying or altering the rights of creditors generally, or of any class of them, secured or unsecured, either through the issuance of new securities of any character or otherwise; * * *" (11 U. S. C. Sec. 303 (b) (1)).

The Courts may also

> "* * * direct the rejection of contracts of the taxing district executory in whole or in part: * * *" (11 U. S. C. Sec. 303 (c) (5)).

(d) Wide-spread similarity of local conditions or events does not transfer power from the States to the Congress.

We shall endeavor to show under Point IV, that no "national emergency" is involved. We now call attention to the principles laid down in *United States v. Butler*, ... U. S. ....., 80 L. ed. (Adv. Ops.) 287, 56 Sup. Ct. Rep. 312, where the Court said:

> "It does not help to declare that local conditions throughout the nation have created a situation of national concern; for this is but to say that whenever there is a widespread similarity of local conditions, Congress may ignore constitutional

limitations upon its own powers and usurp those reserved to the states. If, in lieu of compulsory regulation of subjects within the states' reserved jurisdiction, which is prohibited, the Congress could invoke the taxing and spending power as a means to accomplish the same end, clause 1 of section 8 of article I would become the instrument for total subversion of the governmental powers reserved to the individual states."

II.

THE LACK OF POWER IN CONGRESS TO SUBJECT A STATE OR ITS GOVERNMENTAL AGENCIES TO BANKRUPTCY IS NOT AIDED BY THE CONSENT OF THE STATE.

If the Congress has power, under the bankruptcy clause, to settle and discharge the obligations of a State (and therefore, as an incident of that power, to compel the acceptance of a composition), then of course it needs no consent of the State to exercise the power, any more than it needs the consent of the State to exercise any other power granted by the Constitution. But if, as we believe, the power does not exist, it is because of limitations implied and expressed in the Constitution itself, and any attempt to claim the power is nugatory and vain unless and until the Constitution is amended so as to grant the power. The powers of the Federal Government cannot be enlarged by mere act of the Legislature of any State, or even by action of the Legislatures of all of the States. The question whether the State Legislature has consented to the administration of its fiscal affairs under Act of Congress is therefore a false ele-

ment in the situation. Such a consent would be as meaningless as a consent that Congress might regulate the punishment of burglary or might adopt zoning ordinances for our cities. New power can be given by new constitutional provision and not otherwise.

As this Court said in the case of *In re Rahrer,* 140 U. S. 545:

> "It does not admit of argument that Congress can neither delegate its powers nor enlarge those of a State."

Conversely, it must be true that the powers of Congress cannot be added to by consent of one or more of the States.

The cases decided under the Wilson Act and the Webb-Kenyon Law, contain nothing that militates against this proposition. Those cases held at most that the police power of the States may operate to affect the interstate shipment of liquor when Congress has (by declaring that shipment to be unlawful), divested it of status as a transaction in interstate commerce entitled to immunity from interference by the States.

Pollard v. Hagan, 3 How. 212, lays down principles bearing on the relation between the powers of the States and the powers of the Federal Government, which we submit, are both fundamental and sound. Some explanation of the events leading up to this case is necessary to an understanding of the decision.

In 1802 part of the land which afterward became the State of Alabama was ceded by the State of Georgia to the United States. The deed provided

that when new States were admitted to the Union, carved out of the territory ceded, they should be admitted with the same status and rights as are possessed by other States of the Union. The cession by Georgia was held to be sanctioned by Article IV, Section 3 of the Constitution. Later the territory of Alabama was formed; and in 1819, Congress passed a statute looking to the admission of Alabama as a State, the new State to consist in part of lands within the cession by Georgia to the United States referred to above. The statute provided in part that the inhabitants of the territory of Alabama should elect a constitutional convention, and that

> "* * * the said convention shall provide, by an ordinance irrevocable without the consent of the United States, that the people inhabiting the said territory, do agree and declare that they forever disclaim all right and title to the waste or unappropriated lands lying within the said territory; and that the same shall be and remain at the sole and entire disposition of the United States; * * *" (3 Stats. 492).

This condition was complied with.

The *Pollard* case was an action of ejectment; and the question in the case was whether a patent from the United States to plaintiff for certain tidelands in Alabama conveyed any title. The defendant contended that the title to tidelands was in the State, and that the patent therefore conveyed nothing. Plaintiff argued, among other things, that

> "* * * by the compact between the United States and Alabama, on her admission into the

> Union, it was agreed, that the people of Alabama forever disclaimed all right or title to the waste or unappropriated lands lying within the State, and that the same should remain at the sole disposal of the United States; * * *"

The Court held this argument to be without merit. Speaking of the agreement between Alabama and the Federal Government, the Court said in part:

> "And, if an express stipulation had been inserted in the agreement, granting the municipal right of sovereignty, and eminent domain to the United States, such stipulation would have been void and inoperative; because, the United States have no constitutional capacity to exercise municipal jurisdiction, sovereignty, or eminent domain, within the limits of a State or elsewhere, except in the cases in which it is expressly granted * * *
>
> "We, therefore, think the United States hold the public lands within the new States by force of the deeds of cession, and the statutes connected with them, and not by any municipal sovereignty which it may be supposed they possess, or have reserved by compact with the new States, for that particular purpose. The provision of the Constitution above referred to shows that no such power can be exercised by the United States within a State."

The Court said that the Act of Congress requiring Alabama's disclaimer

> "* * * cannot operate as a contract between the parties, but is binding as a law. Full power is given to Congress 'to make all needful rules and regulations respecting the territory or other

property of the United States.' This authorized the passage of all laws necessary to secure the rights of the United States to the public lands, and to provide for their sale, and to protect them from taxation.

"And all constitutional laws are binding on the people, in the new States and the old ones, whether they consent to be bound by them or not. Every constitutional act of Congress is passed by the will of the people of the United States, expressed through their representatives, on the subject matter of the enactment; and when so passed it becomes the supreme law of the land, and operates by its own force on the subject matter, in whatever State or territory it may happen to be. The proposition, therefore, that such a law cannot operate upon the subject matter of its enactment, without the express consent of the people of the new State where it may happen to be, contains its own refutation, and requires no farther examination. The propositions submitted to the people of the Alabama territory, for their acceptance or rejection by the act of Congress authorizing them to form a constitution and State government for themselves, so far as they related to the public land within that territory, amounted to nothing more nor less than rules and regulations respecting the sales and disposition of the public lands. The supposed compact relied on by the counsel for the plaintiffs, conferred no authority therefore, on Congress to pass the act granting to the plaintiffs the land in controversy."

The statute looking to the admission of Alabama contained a further provision that

> "* * * all navigable waters within the said state shall forever remain public highways, free to the citizens of said state and of the United States, without any tax, duty, impost, or toll, therefor, imposed by the said state."

Speaking of this provision, the Court said:

> "In the case of Martin et al. v. Waddel (16 Peters, 410), the present Chief Justice, in delivering the opinion of the court, said: 'When the Revolution took place, the people of each State became themselves sovereign; and in that character hold the absolute right to all their navigable waters, and the soils under them for their own common use, subject only to the rights since surrendered by the Constitution'. Then to Alabama belong the navigable waters, and soils under them, in controversy in this case, subject to the rights surrendered by the Constitution to the United States; and no compact that might be made between her and the United States could diminish or enlarge these rights.
>
> "The declaration, therefore, contained in the compact entered into between them when Alabama was admitted into the Union, 'that all navigable waters within the said State shall forever remain public highways, free to the citizens of said State, and of the United States, without any tax, duty, impost, or toll therefor, imposed by the said State', would be void if inconsistent with the Constitution of the United States."

It appears to be clear, therefore, that the State's consent cannot save the Federal statute.

III.

THE CHARACTER OF IRRIGATION DISTRICTS.

Irrigation districts are quasi municipal corporations, governmental agencies of the State endowed with some of its sovereign powers, including the power to borrow on the credit of taxation, and the power of taxation itself.

> 1 *McQuillin, Municipal Corporations* (2d ed.), Sec. 135.

Such districts are described as follows by the Supreme Court of California in *Morrison v. Smith Bros. Inc.*, 211 Cal. 36:

> "The other type of public corporation upon whose tort liability this court has already passed is typified by irrigation, reclamation or drainage organizations, whose main purpose is to assist the state in reclaiming, improving and aiding the productivity of farm lands. In reference to this type of organization the law is well settled that, subject to certain exceptions not important in this case, they are not liable for the torts of their agents, upon the theory that they are state agencies, performing a governmental function. (Whiteman v. Anderson-Cottonwood Irr. Dist., 60 Cal. App. 234, 236 (212 Pac. 706); Nissen v. Cordua Irr. Dist., 204 Cal. 542 (269 Pac. 171).) * * * In the leading case of In re Madera Irr. Dist., 92 Cal. 296, 318 (27 Am. St. Rep. 106, 14 L. R. A. 755, 28 Pac. 272, 675), such organizations were referred to as 'public corporations' for 'governmental purposes', and, at page 317, as 'the agents or representatives of the state in the particular locality in which they exist'. In Nissen v. Cordua Irr. Dist., supra, at page 545, and in Lindsay-Strathmore Irr. Dist. v. Su-

perior Court, 182 Cal. 315, 335 (187 Pac. 1056), they are referred to as 'public agencies'. In Jenison v. Redfield, 149 Cal. 500, 501 (87 Pac. 62), they are called 'public corporations'. In Turlock Irr. Dist. v. White, 186 Cal. 183, 187 (17 A. L. R. 72, 198 Pac. 1060), it was said 'that such a corporation is not a municipal corporation, but a public corporation for municipal purposes.' In People v. Reclamation Dist., 117 Cal. 114, 120 (48 Pac. 1016), it was said that 'if these districts can be said to be corporations at all, I think they are properly called public corporations for municipal purposes. That phrase means no more than that they are state organizations for state purposes.' In Whiteman v. Anderson-Cottonwood Irr. Dist., supra, at page 237, it is said: 'As to the character of irrigation districts as organized under our statute, it must be conceded that they are public corporations or public agencies, but not "municipal corporations" as that term is usually understood.' And in Western Assur. Co. v. Sacramento etc. Drainage Dist., 72 Cal. App. 68, 76 (237 Pac. 59), they are referred to as 'governmental agencies of the state'."

See, also:

Hensley v. Reclamation District No. 556, 121 Cal. 96, 97;

Lindsay-Strathmore Irrigation District v. Superior Court, 182 Cal. 315, 335.

(a) The acts of quasi municipal corporations are acts of the State.

There can, we submit, be no doubt that when a quasi municipal corporation borrows money or makes contracts or levies taxes in aid of public improvements,

the validity of its acts rests upon, and they are an exercise of, the power of the State to further the public welfare by such means, either through the agency of the central government of the State or through agencies like these. In addition to the authorities cited above, see

Memphis & C. Ry. Co. v. Pace, 282 U. S. 241.

In *Fallbrook Irrigation District v. Bradley,* 164 U. S. 112, 174, the Court said, speaking of California irrigation districts:

> "The formation of one of these irrigation districts amounts to the creation of a public corporation, and their officers are public officers."

In *Houck v. Little River Drainage District,* 239 U. S. 254, 263, a Missouri drainage district was described by Mr. Justice Hughes, as he then was, as having been "constituted a political subdivision of the State for the purpose of performing prescribed functions of government."

IV.

THE MUNICIPAL BANKRUPTCY PROVISION CANNOT BE DEFENDED AS AN "EMERGENCY MEASURE".

Section 78 of the Bankruptcy Act recites in defense of the municipal bankruptcy provision, that

> "There is hereby found, determined, and declared to exist a national emergency caused by increasing financial difficulties of many local governmental units, which renders imperative the further exercise of the bankruptcy powers of the Congress of the United States."

But in *A. L. A. Schecter Poultry Corp. v. United States,* 295 U. S. 495, it was held that

> "Extraordinary conditions do not create or enlarge constitutional power."

It may be observed moreover, that events have not substantiated this legislative declaration. It is said that but five States have enacted statutes authorizing their municipalities to invoke Section 80; and that in the ten months that have elapsed since its enactment, only a handful of the thousands of municipalities and State agencies in the country have sought the proffered relief. 35 *Columbia L. Rev.* 428, 437, 438.

V.

SECTION 80 VIOLATES THE FUNDAMENTAL PRINCIPLES OF BANKRUPTCY, AND SO IS NOT A LAW "ON THE SUBJECT OF BANKRUPTCIES".

The case of *Northern Pacific Ry. Co. v. Boyd,* 222 U. S. 482 (as elaborated in later decisions), establishes the following fundamental qualities that a plan of corporate reorganization must have to be binding on non-consenting creditors:

(1) It must give precedence to the entire claims of creditors, including unsecured creditors, over any participation or interest of stockholders in the old company.

(2) The entire amount of claims of a preferred class must have precedence over claims of subordinate classes.

(3) The plan must not discriminate among the members of any one class of creditors.

The fourth syllabus in *Kansas City Terminal Ry. Co. v. Central Union Trust Co.*, 271 U. S. 445, reads in part as follows:

> "* * * a plan of reorganization of railroad company which does not give precedence to entire claim of unsecured creditors over any part or interest of stockholders in old company, is insufficient as to unsecured creditors, and not binding on them."

It is well settled that for a plan to be fair as between classes of creditors, it must satisfy their claims in the order of priority.

Louisville Trust Co. v. Louisville Ry. Co., 174 U. S. 674;

St. Louis-S. F. Ry. Co. v. McElvain, 253 F. 123;

Mountain States Power Co. v. Jordon Lumber Co., 293 F. 502.

In *Eagelson v. Pacific Timber Co.*, 270 Fed. 1008, the plan gave persons holding common stock share for share in the new company, but holders of common who also held preferred stock were not permitted to trade in their common until they had paid $10 in cash for each share of preferred, for which they received a new preferred share of $10 par value. The majority of common stockholders held common only. The dissenting minority held common and preferred in about equal amounts. The Court said at page 1110:

> "* * * The several holders of the common stock were, among themselves, denied equal rights of participation in the new company * * * as the

312

> holders of more than half of the common stock * * * had none, or practically no preferred stock, while many persons, including the plaintiff and the intervenors, held substantially equal amounts of preferred and common stock, it is manifest that the plan of reorganization was for the benefit of the majority to the detriment of the minority, and consequently unfair and fraudulent."

We respectfully submit that the principles referred to above are fundamental, and inherent in the idea of bankruptcy.

As applied to debts of governmental agencies, Section 80 inevitably violates each of them, as we now propose to show.

The Court may take judicial notice of the fact that bonds of municipalities, school districts, drainage districts, improvement districts, and so on, almost universally overlap, so that bonds of two or more of such governmental agencies will almost always be found to be collectible by taxation of the same land. The scaling down of the debts of an irrigation district, therefore, will in almost all cases necessarily result in discrimination against those debts, and in favor of the holders of bonds of other governmental agencies, collectible by taxation of the same land. For to the extent that the ability of the land to pay is improved by the scaling down of the debts dealt with in the bankruptcy proceeding, the position of overlapping bonds is improved.

Bonds of governmental agencies are, of course, sometimes of equal rank and sometimes not. In Cali-

fornia, for example, most county, municipal and quasi municipal bonds are of equal rank.

La Mesa Irr. Dist. v. Hornbeck, 216 Cal. 730;
San Joaquin Irr. Dist. v. Neumiller, 2 Cal. (2d) 485.

Public bonds are universally prior in rank to mortgages and other liens securing private debts.

The result, therefore, of the application of Section 80 to public bonds is inevitably to prefer junior claims to senior claims, and to discriminate among claims of equal rank.

It is almost universally held that the property of municipal and quasi municipal corporations is, with occasional and minor exceptions, incapable of being sold or otherwise subjected to the claims of creditors.

> "The property of a public corporation acquired by it for public uses, and in its capacity as a governmental agent, is held in trust for the uses and purposes for which acquired. Trust property owned by a municipality and held for public purposes can not be reached by process and sold to satisfy its debts any more than other trust property can be sold to satisfy individual debts of any other trustee. A judgment against a municipality, therefore, in the absence of express statutory provisions, can not be enforced by execution; nor is it a lien upon any of its property. This principle has been universally adopted on the grounds of public policy, since, it is not considered permissible or advisable that the state or its governmental subdivisions should be hampered or prevented through a loss of its public property from exercising its public pow-

ers or carrying out its governmental functions." (1 *Jones, Bonds and Bond Securities* (4th ed.), Sec. 480. See also Sec. 543.)

But most of this same property is generally acquired with funds obtained by the sale of bonds. Section 80, therefore, necessarily results as follows: An irrigation district or other similar district is organized and acquires assets by the issuance of bonds. It later becoming inconvenient for the district to meet its obligations, it applies for relief under Section 80. The district in this proceeding has everything to gain and nothing to lose; the Court has no power to force any plan on the district against its consent; it has no power to subject the assets of the district to the satisfaction of the claims of its creditors. On the other hand, if by obstruction, delay and intimidation, the district can persuade the required proportion of its bondholders to consent, it may not only escape from its obligations, but may keep all of the property bought with the proceeds.

We earnestly submit that in view of these considerations, the relations between these governmental agencies and their creditors are such as to render it impossible to subject that relation to the operation of bankruptcy proceedings without violating both the fundamental rights of the bondholders and the elementary principles of justice discussed above, which, we submit, are inherent in the idea of bankruptcy.

(a) Action under Section 80 is no less a repudiation of public debts because the statute requires the consent of a proportion of creditors.

In support of the proposition just stated, we refer to *Louisville Joint Stock Land Bank v. Radford,* 295 U. S. 555.

It is to be observed, moreover, that the circumstances attending a "composition" between a State agency and its creditors are very different from what they are in the case of a private debtor. The capacity of a State or its governmental agencies to frustrate their creditors is well known. In *Rees v. Watertown,* 19 Wall. 107, plaintiff owned bonds of a city. A writ of mandamus directing the city council to levy a tax had proven fruitless. It was here sought to have the Court itself levy a tax. The Court said:

> "We are of the opinion that this court has not the power to direct a tax to be levied for the payment of these judgments. This power to impose burdens and raise money is the highest attribute of sovereignty, and is exercised, first, to raise money for public purposes only; and, second, by the power of legislative authority only. It is a power that has not been extended to the judiciary. Especially is it beyond the power of the Federal judiciary to assume the place of a state in the exercise of this authority at once so delicate and so important."

In *Heine v. Board,* 19 Wall. 655, a similar case, the Court said:

> "It is not only not one of the inherent powers of the court to levy and collect taxes, but it is an invasion by the judiciary of the Federal Govern-

ment of the legislative functions of the state government. It is a most extraordinary request, and a compliance with it would involve consequences no less out of the way of judicial procedure, the end of which no wisdom can foresee."

See:

Jones, Bonds and Bond Securities (4th ed.), Secs. 486, 490.

Assuming, as appears to have been intimated in the *Radford* case, supra, that consent to a plan by a majority of a class of creditors may sometimes be sufficient assurance that the plan is "for the best interest of the creditors", and not a "taking" of their property, we submit that no such inference can be drawn from consent given by a proportion of the creditors of a State or political subdivision.

VI.

THIS COURT HAS NEVER HELD THAT SECURED CREDITORS, EVEN WHEN MEMBERS OF A CLASS, MAY BE COMPELLED TO SURRENDER SUBSTANTIAL SECURITY RIGHTS.

The decisions of this Court in *Continental Illinois National Bank & Trust Company v. Chicago R. I. & P. R. Co.*, 294 U. S. 648, and *Louisville Joint Stock Land Bank v. Radford*, 295 U. S. 555, leave open the question whether the property rights of a secured creditor may, consistently with the Fifth Amendment, be taken from him against his consent in a bankruptcy proceeding, where a majority of similar creditors consent.

(a) The holders of public bonds are in effect secured creditors.

Generally speaking, public bonds are not a lien on any property. 1 *Jones, Bonds and Bond Securities* (4th ed.), Sec. 480. It is submitted, however, that the right of the holders of municipal and quasi municipal bonds to compel the exercise of the taxing power for the satisfaction of their claim is at least as definitely a property right as are the rights of mortgagees. Mortgagees in most States now have only a lien, the primary value of which is the right to compel a sale of the property and application of the proceeds to the debt. The rights of a public bondholder are at least of equal dignity; he, like the mortgagee, has a preferred right to compel the sale of property for the satisfaction of his claim.

VII.

THE FUNDAMENTAL QUESTIONS OF PUBLIC POLICY INVOLVED IN THE REPUDIATION OF PUBLIC DEBTS MUST BE DECIDED BY THE SOVEREIGN WHOSE DEBTS ARE IN QUESTION.

We need not enlarge upon the gravity and fundamental nature of the questions of public policy that are decided one way or the other by the repudiation of public debts. And surely the bankruptcy clause contains no warrant for the proposition that power to decide these questions for the States is granted to the Congress.

As shown above, if the power is not granted, then acquiescence by the States, or some of them, in Congressional usurpation adds nothing to the situation.

(a) The inviolability of public obligations stands above the bankruptcy power.

Neither the Federal Government nor a State has authority to alter or destroy its obligations. See *Perry v. United States*, 294 U. S. 330.

We respectfully submit that this proposition rests on higher ground than can be reached by power to enact uniform laws on the subject of bankruptcies.

VIII.

CONCLUSION.

Because of the considerations dealt with above, and in the brief of petitioners, we respectfully urge that Section 80 of the Bankruptcy Act is unconstitutional.

Dated, San Francisco, California,
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Respectfully submitted,
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As Amici Curiae.